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# Bow to Behemoths? Or Push for a Better Way?

**Brokers and small lenders should be seen not as the problem but as the solution**

**T**his past September, the Mortgage Bankers Association (MBA) released its proposal for changes to the federal government's role in the secondary mortgage market. The proposal added MBA's voice to the cluttered chorus of those calling for reform.

President Barack Obama has released his proposal for overhauling the financial industry, and the Federal Reserve, the Federal Deposit Insurance Corp., and the U.S. Department of Housing and Urban Development also have published opinions about how the next generation of mortgage lending should function. Meanwhile, Congress also is considering various bills complete with more ideas about what future mortgage markets should look like.

To know what's best from here out — and in what fashion brokers should react, if they're concerned about the future of the broker channel and of smaller banks — we must realize where we have been.

## Targeting brokers

The previous model in the mortgage industry focused on consumers' choice and began with their selection of a mortgage professional. If done properly, the loan process would account for consumers' wants and needs while evaluating their ability and willingness to repay. In large part, loans were underwritten by funding entities that bore responsibility to secondary-market investors.

After funding, many loans were sold to Fannie Mae or Freddie Mac. In turn, the loans were securitized and sold to investors as mortgage-backed securities

(MBSs). The rates of loans consumers received often were based on investors' expected MBS yields.

But in the past few years, the federal government has increased its role in mortgage markets through takeovers and by placing Fannie Mae and Freddie Mac into conservatorship. The Home Valuation Code of Conduct — prohibiting mortgage brokers from ordering appraisals for loans sold to Fannie and Freddie — also had significant impacts on market fundamentals.

On top of all this, the Federal Reserve Board's proposed changes to the Truth in Lending Act are up for public comment until Dec. 24 ([sctsm.in/TILAcM](http://sctsm.in/TILAcM)). A prominent part of the proposed changes is the prohibition of fees paid to loan originators based on loan terms or rate. Although the proposed changes intend to prevent brokers from steering customers into risky loans for the sake of greater commissions, they also could increase upfront costs and prevent consumers from financing those costs into their loans.

Despite these changes and others — some of which take direct aim at the broker channel — mortgage brokers traditionally have provided banks with an efficient marketing and product-distribution tool. Banks could sell their products without the expense of location, overhead, payroll, utilities, etc., and pay only for completed transactions.

For this reason, it remains possible for consumers to get cheaper loans by going to brokers who work with wholesale divisions of lenders than to go directly to the retail divisions of the same lenders.

Nonetheless, many of the already-enacted regulations and proposed legislative changes push smaller, independent lenders and brokers out of the market. Moreover, recent experience demonstrates that the federal government is willing to help the largest banks acquire other failing entities.

In other words, it seems the best way to receive government assistance is to become large enough to help the government solve immediate problems.

This likely means that many small banks soon will have to merge to establish enough capital to survive the trend of acquisition. This could leave regional banks and credit unions as the only competition for huge, essentially government-backed banks.

## Power in diversity

When and if this occurs, mortgage transactions will no longer focus on consumers but on the large entities that control the lending markets. Product selection will be restricted, and borrowers no longer will require professionals — e.g., mortgage brokers — to guide them.

Brokers could be replaced with hourly employees who help consumers fill out paperwork, and giant banks will have little incentive to keep down loan costs. Other than a mandate from their oversight body, the bank behemoths will control prices in the market.

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If these things happen, loans funded by the banking giants will receive scrutiny from a highly empowered Federal Reserve, which also will buy the loans, securitize them and sell MBSs on the open market with the full faith and backing of the United States. Ultimately, the Fed will influence rates by controlling supply instead of increasing demand.

If this sounds like a nightmare for brokers, that's because it is. In addition, the pieces that put this plan in motion conveniently forget that the secondary market that led to financial calamity also created more homeowners than any other system. It's not necessary to re-create the entire process. Instead, we should fix the areas that sent the mortgage market out of control.

This can be done by focusing on caution, competition and conversation. Mortgage

bankers and their huge lobbying contingent can't be allowed to drive the agenda. The government wants to protect consumers, but it shouldn't do so by eliminating their choices. Regulators want tighter control, but they shouldn't be allowed to stifle innovation.

Instead of creating giant corporations, we should encourage smaller companies to play a larger role. In a market dominated by giants, innovation suffers. And if for some reason one of the banking behemoths does fail, it could create a rerun of the catastrophe we just experienced — or worse.

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We're headed down a path that limits bad choices by limiting options. Instead, we should reward good decisions and punish bad ones while providing tools for

consumers to evaluate all options presented to them. The new mortgage market must be crafted with input from all stakeholders, including mortgage brokers and consumer-advocacy groups. It should allow for exotic mortgages designed for specific needs and prevent the same products from becoming mainstream.

Rather than back huge banks, industry and government powers should promote smaller corporations that succeed or fail based on their ideas and performance. In addition, education efforts aimed at all parties in mortgage transactions — including borrowers and brokers — will help the proliferation of informed decisions.

Only by reversing the shift toward a conglomerate culture can we create a safe mortgage environment that protects consumers and affords them choice. ●